Money from the Masses

*By Teresa V. Pahl & Jonathan S. Storper **

Hanson Bridgett Corporate Practice Group

HANSONBRIDGETT.COM

HansonBridgett

Capital investment is going viral. By early 2013, companies should be allowed to raise capital online from numerous, previously untapped investors. On April 5, 2012, President Obama signed the Jumpstart Our Business Start-Ups (JOBS) Act, which included the Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure (CROWDFUND) Act. Once the Securities and Exchange Commission (SEC) has finalized the applicable rules and regulations, the CROWDFUND Act should provide an additional exemption to SEC registration requirements, freeing up the ability of an emerging company to raise money from new investors.

Although some parts of the JOBS Act are already in effect, the CROWDFUND Act includes a 270-day rulemaking period for the SEC to develop specific regulations related to "crowdfunding." According to the SEC's current timeline, the new rules should be complete by December 31, 2012, with the crowdfunding registration exemption available early in 2013.

The concept of "crowdfunding" involves soliciting relatively small investments from a large number of people. This concept has already been used to fund projects such as international concert tours, startup watch companies, and a revival of a discontinued video game series. Websites such as kickstarter.com and rockethub.com offer companies and individuals an opportunity to pitch their business ideas or creative proj-

* Content for this article was contributed by Adam Gopin (Hanson Bridgett Associate) and Kyle Mabe (Hanson Bridgett Summer Associate).

ects online where others may then “donate” various dollar amounts to the projects. In exchange for these “donations,” investors receive rewards, such as sample products from the company or exclusive tickets to a concert. Selling an ownership interest in the company itself, however, still subjects a company, regardless of size, to significant SEC reporting requirements under federal securities laws.

Under the CROWDFUND Act, on the other hand, a company will be able to raise such funding by selling its own equity interests without violating federal and state securities regulations, and should only be subject to minimal SEC reporting requirements. And whereas current securities regulations deter companies from offering equity to non-high net worth individuals, the CROWDFUND Act should open up access to a previously inaccessible group of investors who wish to buy a stake in a company’s future.

The CROWDFUND Act, however, will not solve all problems for an emerging company seeking to raise funds through an equity offering, as the final rules will contain a number of significant limitations, including:

- Fund raising cap: Companies will be prohibited from raising more than $1,000,000 through crowdfunding in any 12-month period.

- “Funding Portals”: Crowdfunding transactions must be offered through a third party “funding portal,” which will itself be subject to disclosure requirements and specific restrictions aimed at, among other things, preventing fraud by equity-issuing companies.

- All-Or-Nothing Target: Companies must meet an “all-or-nothing” target funding amount and will not have access to funds raised via crowdfunding until the aggregate of all money raised reaches a pre-determined target amount. Investors may cancel their investment commitments if that amount is not reached.

- Per-Investor Limits: Companies will be prohibited from selling more than $2,000 worth of securities per year to any individual whose annual income is less than $100,000. For investors with annual income greater than $100,000, companies may only sell them securities worth less than 10% of such investor’s annual income, not to exceed $100,000.

- Transfer Limits: Equity shares sold through crowdfunding will be non-transferable for a year after their purchase.

- Advertising Limits: Companies may not advertise the terms of an offering except to point investors to the funding portal. Furthermore, companies will not be allowed to compensate promoters of the offering, except as specifically determined by the SEC in future rulemaking.

- Registration and Disclosure Requirements: Companies using crowdfunding will be required to register with the SEC, though the attendant disclosure requirements, which will vary based on the funding target amount, should be minimal.

- Covered Securities: Securities issued in a crowdfunding transaction will be "covered securities" and exempt from state blue sky registration requirements.

Until the SEC has finalized and approved the legal mechanics related to crowdfunding, its practical utility remains to be seen. The internet's anonymity provides ample opportunity for unscrupulous entities to defraud financially unsophisticated individuals. Crowdfunding could prove to be an integral component of a start-up company's early stage capitalization, but SEC concerns regarding such fraudulent activities could lead to overly burdensome regulations, making equity-based crowdfunding too costly for those who would benefit from it the most. In either event, early 2013 will be an exciting time for the capital investment market.

If you have any additional questions, please contact:

Teresa V. Pahl
Direct Phone: 415-995-5079
tpahl@hansonbridgett.com

Jonathan S. Storper
Direct Phone: 415-995-5040
jstorper@hansonbridgett.com

Scott C. Smith
Direct Phone: 415-995-5892
ssmith@hansonbridgett.com

Leslie A. Keil
Direct Phone: 415-995-5125
lkeil@hansonbridgett.com

Michael J. Gorback
Direct Phone: 650-358-1367
mgorback@hansonbridgett.com

Adam J. Gopin
Direct Phone: 415-995-5120
agopin@hansonbridgett.com

SAN FRANCISCO

425 Market Street, 26th floor
San Francisco, CA 94105
TEL 415-777-3200
FAX 415-541-9366

NORTH BAY

Wood Island
80 E. Sir Francis Drake Blvd., Ste. 3E
Larkspur, CA 94939
TEL 415-925-8400
TEL 707-546-9000
FAX 415-925-8409

SACRAMENTO

500 Capitol Mall, Ste. 1500
Sacramento, CA 95814
TEL 916-442-3333
FAX 916-442-2348

SILICON VALLEY

950 Tower Lane, Ste. 925
Foster City, CA 94404
TEL 650-349-4440
FAX 650-349-4443

EAST BAY

1676 N. California Blvd., Ste. 620
Walnut Creek, CA 94596
TEL 925-746-8460
FAX 925-746-8490